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REPORT
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VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1989

JUNE 1, 1989.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. MONTGOMERY, from the Committee on Veterans' Affairs, submitted the following

REPORT

[To accompany H.R. 1415]

[Including cost estimate of the Congressional Budget Office]

The Committee on Veterans' Affairs, to whom was referred the bill (H.R. 1415) to amend chapter 37 of title 38, United States Code, with respect to the veterans' home loan program carried out under such chapter, having considered the same, reports favorably thereon with an amendment, by unanimous voice vote, and recommends that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Veterans' Home Loan Mortgage Indemnity Act of 1989".

SEC. 2. ESTABLISHMENT OF SPECIAL INDEMNITY FUND AND LOAN FEE.

(a) SPECIAL INDEMNITY FUND.—(1) Chapter 37 of title 38, United States Code, is amended by adding the following new section after section 1824:

"§ 1824A. Mortgage indemnity fund

"(a) There is hereby established in the Treasury of the United States a revolving fund known as the Veterans' Mortgage Indemnity Fund (hereafter referred to as the 'Indemnity Fund').

"(b) The Indemnity Fund shall be available to the Secretary for all operations (other than administrative expenses) carried out with respect to housing loans guaranteed or insured under this chapter which are made on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989, other than loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

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"(c)(1) All fees collected under section 1829 of this title on or after such effective date shall be credited to the Indemnity Fund, other than fees collected with respect to loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

"(2) There shall also be credited to the Indemnity Fund—

"(A) for each housing loan guaranteed or insured under this chapter on or after October 1, 1989, an amount equal to 0.25 percent of the original amount of such loan for each of the three fiscal years beginning with the fiscal year in which such loan is guaranteed or insured;

"(B) all connections of principal and interest and the proceeds from the use of the property held, or from the sale of property disposed of, with respect to loans to which subsection (b) of this section applies; and

"(C) all income from the investments described in subsection (d) of this section.

"(d)(1) The Secretary of the Treasury shall invest the portion of the Indemnity Fund that is not required to meet current payments made from the Indemnity Fund, as determined by the Secretary of Veterans' Affairs, in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

"(2) Such obligations shall have maturities suitable to the needs of the Indemnity Fund, as determined by the Secretary of Veterans' Affairs, and shall bear interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities.".

(2) The table of sections of subchapter III of section 37 of such title is amended by inserting after the item for section 1824 the following new item:

"1824A. Mortgage indemnity fund.".

(b) LOAN FEE.—Section 1829 of such title is amended to read as follows:

"§ 1829. Loan fee

"(a)(1) Except as provided in subsection (c), a fee shall be collected from each veteran obtaining a housing loan guaranteed or insured under this chapter, and from each person obtaining a loan under section 1833(a), and no such loan may be guaranteed, made, or insured under this chapter until the fee payable under this section has been remitted to the Secretary.

"(2) The amount of such fee shall be 1.25 percent of the total loan amount, except that—

"(A) in the case of a loan made under section 1833(a), the amount of such fee shall be one percent of the total loan amount; and

"(B) in the case of a guaranteed or insured loan for a purchase or construction with respect to which the veteran has made a downpayment of not less than 5 percent of the total purchase price or construction cost, the amount of such fee shall be 0.75 percent of the total loan amount.

"(3) The amount of the fee may be included in the loan and paid from the proceeds thereof.

"(b) Except as provided in subsection (c), a fee shall be collected from a person assuming a loan to which section 1814 of this title applies. The amount of the fee shall be equal to one-half of one percent of the balance of the loan on the date of the transfer of the property.

"(c) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.".

(c) LIABILITY.—Section 1803 of such title is amended by adding at the end the following:

"(e) Any veteran who pays a fee under section 1829 of this title, or is exempted under section 1829(c) from paying such fee, on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989 with respect to housing loan (other than a loan made under section 1833(a) or a loan for which a fee is collected under section 1829(b)) shall have no liability to the Secretary with respect to the loan for any loss resulting from any default of any veteran except in the case of fraud, misrepresentation, or bad faith by the veteran in obtaining the loan or in connection with the loan default.".

(d) CONFORMING AMENDMENTS.—(1) Section 1824 of such title is amended—

(A) in subsection (b), by inserting the following before the period at the end of the first sentence: "and the operations carried out with the Indemnity Fund established by section 1824A"; and

(B) in subsection (c)—

(i) by inserting after "title" in clause (2) the following: "before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989, except that fees collected under subsection (b) of such section 1829 on or after such effective date with respect to loans which were originally guaranteed, made, or insured before such effective date shall also be deposited in the Fund"; and

(ii) by inserting after "chapter" in clause (3) the following": "with respect to housing loans guaranteed or insured under this chapter before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989".

(2) Section 1832(a)(1) of such title is amended by striking out "If" in the last sentence and inserting in lieu thereof "Except as provided in section 1803(e), if".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any loan closed on or after October 1, 1989.

SEC. 3. SALE OF VENDEE LOANS.

(a) IN GENERAL.—Section 1833(a)(3) of title 38, United States Code, is amended to read as follows:

"(3)(A) The Secretary may sell any note evidencing such a loan with or without recourse, but only if the cash proceeds received at the time of such sale is equal to an amount which is not less than 90 percent of the unpaid balance of such loan.

"(B) All amounts received from the sale of such loans shall be credited, without any reduction and for the fiscal year in which the amount is received, as offsetting collections of the Fund, established by section 1824 or by section 1824A, for which a fee was collected (or from which a fee was exempted from being collected) at the time the loan was originally guaranteed. The total credited to such Fund for a fiscal year shall offset outlays attributed to such Fund during the fiscal year.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on October 1, 1989.

SEC. 4. COMPUTATION OF ENTITLEMENT AMOUNT.

Section 1802(b) of title 38, United States Code, is amended—

(1) by striking out "or" at the end of clause (1)(B);

(2) by striking out the period at the end of clause (2) and inserting in lieu thereof "; or"; and

(3) by inserting after clause (2) the following new clause:

"(3) the loan has been repaid in full.".

SEC. 5. WAIVER.

Subsection (c) of section 3102 of title 38, United States Code, is amended—

(1) by striking out ", misrepresentation, material fault, or lack of good faith"; and

(2) by adding at the end the following new sentence: "The Secretary may not make a determination with respect to equity and good conscience under subsection (b) solely on the basis of a balancing of fault or on whether the veteran might be able to repay the indebtedness.".

SEC. 6. COMPUTATION OF COSTS; EXTENSION.

(a) COSTS.—Section 1832(c)(1)(C)(ii) of title 38, United States Code, is amended by inserting before the period the following: ", excluding any estimated imputed interest costs of funds to the Government".

(b) EXTENSION.—Section 1832(c)(11) of such title is amended by striking out "October 1, 1989" and inserting in lieu thereof "October 1, 1991".

SEC. 7. NOTIFICATION REQUIREMENT.

Section 1832(a) of title 38, United States Code, is amended by adding at the end the following:

"(5) In the event of default in the payment of any loan made, guaranteed, or insured under this chapter in which a partial payment has been tendered by the veteran concerned and refused by the holder, the holder of the obligation shall notify the Secretary as soon as such payment has been refused. Such notification shall include a statement of the circumstances of the default and the reasons for the holder's refusal.".

Introduction

In 1988, the Subcommittee on Housing and Memorial Affairs initiated a series of extensive oversight hearings on the solvency of the Department of Veterans Affairs Home Loan Guaranty Program. The testimony reiterated the positive nature of the Home Loan Guaranty Program which has benefited 13.1 million veteran homeowners since its inception. The fact that approximately two-thirds of the outstanding loans have been repaid in full is a tribute to the program's success.

As a result of these hearings and informal discussions with other federal agencies and ad hoc committees, legislation to create a mortgage indemnity program was introduced and considered by the House last year. H.R. 5221 was passed by the House on September 26, 1989 but no action was taken in the other body.

The bill was re-introduced as H.R. 1415 by the Hon. Harley O. Staggers, Jr., on March 15, 1989 and hearings were held by the Subcommittee on Housing and Memorial Affairs on April 18, 1989. Testimony was received from the Department of Veterans Affairs, the Government National Mortgage Association, Mr. David Leen, Attorney, Seattle, Washington, the National Association of Realtors, the Mortgage Bankers Association of America, the National Association of Home Builders, the Manufactured Housing Institute, the Non-Commissioned Officers Association, The American Legion, the Disabled American Veterans, the Veterans of Foreign Wars, the Paralyzed Veterans of America, and the Vietnam Veterans of America. The Subcommittee met on May 11, 1989 and unanimously recommended an amendment to the full committee in the nature of a substitute to H.R. 1415. On May 17, 1989, the full committee unanimously recommended that H.R. 1415, as amended, be reported to the House.

Summary of the Bill

H.R. 1415, as amended, would:

(1) Establish a Veterans' Mortgage Indemnity Fund (MIF) in the Treasury of the United States for all operations (except administrative expenses) carried out with respect to Department of Veterans Affairs guaranteed or insured housing loans.

(2) Relieve veterans obtaining guaranteed or insured loans from the Department of Veterans Affairs from liability to the Secretary of the Department in the event of foreclosure unless there are indications of fraud, misrepresentation or bad faith on the part of the veteran in obtaining the loan or in connection with the loan default.

(3) Require payment of the following mortgage indemnity fees:

(a) Three-quarters of one percent of the total loan amount in the case of a veteran making a down-payment of five percent or more;

(b) No fee from compensably rated service-connected disabled veterans and service-connected surviving spouses of veterans whose deaths are service connected.

(c) One and one-quarter percent of the total loan amount to be paid by other veterans.

(4) Require an annual payment to the MIF of an amount equal to one-quarter of one percent of the loan amount for the first 3 years to be paid to the Fund by the Federal Government.

(5) Require the investment of excess funds in Government securities.

(6) Continue the current one percent fee for vendee loans, with purchasers remaining liable for losses.

(7) Continue the current one-half of one percent fee for assumed loans, with purchasers remaining liable.

(8) Require that loan asset sales be scored as offsetting collections regardless of whether loans are sold with or without recourse and specify that ninety percent or more of the unpaid balance must be received at time of sale.

(9) Modify refinancing loan provisions and allow for easier refinancing of certain conventional loans.

(10) Provide that the Secretary may not make a determination as to whether or not it would be against equity and good conscience to recover an indebtedness based solely on a balancing of fault or whether the veteran might be able to repay the debt at some future date.

(11) Extend the Department of Veterans Affairs foreclosed property acquisition formula until October 1, 1991 and specify that imputed interest costs must be excluded from "net value" determination.

(12) Require lenders to notify the Secretary immediately should the lender refuse to accept a partial payment from a veteran and include the reasons for refusal in such notice.

Background

The Home Loan Guaranty Program was established under the Servicemen's Readjustment Act of 1944 (P.L. 78-346). As World War II drew to a close, Congress sought ways to ease the economic and sociological readjustment of returning servicemen and women to civilian life. The program was an innovative means of affording veterans favorable credit which would allow them to purchase a home, business or farm. Many of these veterans, because of their service in the Armed Forces, had missed an opportunity for establishing personal credit or for accumulating enough money for a substantial downpayment on a home. By utilizing the guaranty of the United States, these veterans were able to enter the homebuying market on a comparable level with their nonveteran counterparts.

Although the objectives of the legislation were specific to the readjustment of returning veterans, rather than influencing the economy as a whole, the Home Loan Guaranty Program, as a by-product, created an excellent investment outlet for the large pool of savings that had been accumulated by the general population during World War II. Channeling this investment capital into a productive peacetime activity was perceived as a means of stimulating the economy and averting to some degree the possibility of post-war depression. Under the original program, guaranties could be made for up to fifty percent of the loan, not to exceed $4,000. There was a 20-year maximum on repayment terms, and a maxi-

mum four percent interest rate. The Department of Veterans Affairs (DVA) may presently guarantee fifty percent of the loan's value for loans under $45,000 and forty percent for loans over $45,000 with a maximum guaranty of $36,000 and a minimum guaranty of $22,500.

Over the years, Congress has enacted many other changes to the program to enhance its viability, and to respond to developments in the economy and to changes in the needs of veterans. There is now no delimiting date for a veteran to make use of this benefit, and entitlement may be regained once the veteran has paid off the initial loan in full and disposed of the property.

Since the inception of the Home Loan Guaranty Program in 1944, approximately 13.1 million veterans have received DVA-backed mortgage assistance. More than two-thirds of these loans have been repaid. The program has been enormously successful in terms of helping veterans become homeowners and has proved to be a powerful stimulus to the nation's economy. Despite the program's obvious success, efforts by the Office of Management and Budget to ease the federal government out of housing programs have tended to weaken the program's potential for serving veterans effectively, and have adversely affected the long-term solvency of the Loan Guaranty Revolving Fund.

HISTORICAL DATA ON THE FINANCIAL CONDITION OF THE LOAN GUARANTY REVOLVING FUND

From 1944 to 1961, the Loan Guaranty Revolving Fund (LGRF) was funded by the Readjustment Benefits Appropriation Account. All program costs due to foreclosure of GI loans were paid from that account, which received annual appropriations. Collections generated from the sale of acquired properties were returned to the U.S. Treasury. No attempt was made to make the program self-sustaining. It was understood that expenses would exceed collections and that appropriations would be necessary to support the program. Each year from 1947 through 1961, appropriations were made to the Readjustment Benefits Account to fund program expenses.

In 1961, the Congress established the Loan Guaranty Revolving Fund in order to make the financial operation of the program manageable. Operationally, the program would be no different. However, receipts from the program operations would be deposited into the fund and be available immediately for ongoing expenditures. The revolving fund would allow for improved budgetary and accounting control as well.

The Direct Loan Revolving Fund (DLRF) was established in 1950 to make direct loans to veterans living in rural areas who could not obtain guaranteed loan financing. Principal and interest collections on direct loans far exceeded new lending requirements, and provided a source of funds for the guaranteed loan program in lieu of direct appropriations. In establishing the Loan Guaranty Revolving Fund, Congress authorized transfers from the Direct Loan Revolving Fund as needed to offset shortfalls previously funded by appropriations. The concept was that one veterans' housing program

(direct loans) could help support the other (guaranteed loans) without appropriations from the Congress.

During the first six fiscal years of the LGRF's existence (1962 through 1967), $633.9 million was transferred to the Fund. In the first 23 years after the inception of the program (1945-1967), appropriations or transfers from the Direct Loan Revolving Fund were necessary in all but two years.

In the mid-1960's, the Office of Management and Budget forced the Department of Veterans Affairs to sell much of its loan portfolio assets. Vendee and direct loans with high-interest yields were sold and only loans with low-interest rates remained in the portfolio. It is probable that this change in policy in conjunction with a stronger economy enabled the LGRF to operate without transfers from the DLRF or appropriations during the next ten fiscal years (1968–1977). During this period, there were four fiscal years in which collections to the fund exceeded expenditures. This change in the historical pattern of costs and collections gave the impression to many observers that the Loan Guaranty Revolving Fund was self-sustaining. In fact, the revolving fund performance reflected overall economic conditions. The economy was relatively stable; the GI mortgage interest rate maximum was in the seven to nine percent range; foreclosure rates and unemployment were low; and real estate values were appreciating sharply. Many veterans who did face financial difficulty during this period were able to dispose of their properties and satisfy their indebtedness without losses being incurred by the Department. As an example, during the 1970's, annual home price appreciation averaged 10.9 percent. This allowed thousands of veterans to escape foreclosures which would undoubtedly occur in many regional markets today.

The financial condition of the LGRF began changing in the late 1970's and it was necessary to transfer $1.5 billion from the Direct Loan Revolving Fund during fiscal years 1978 to 1983. Increasing interest rates had a negative impact on the program. Mortgage interest rates rose sharply in 1980 in response to changes in Federal Reserve policy. In 1980, the average GI interest rate was almost 12 percent. Of all loans guaranteed that year, 11.6 percent have gone to foreclosure compared with 3.5 percent for 1977 loans. GI home loan interest rates peaked at 17.5 percent in 1982. This increase in interest rates was coupled with a severe recessionary period, characterized by high unemployment, factory closings, and personal bankruptcies.

Although the Department's experience with foreclosures was not unique, the Direct Loan Revolving Fund was nearly depleted as a result of the transfers from 1978 to 1983. Principal and interest receipts from the loan portfolio had been dissipated as a result of the sales policy which had been initiated in the 1960's. It was at this point that the Department of Veterans Affairs should have concentrated its efforts on debt avoidance by increasing loan servicing and property management. Instead, a shortsighted OMB policy forced the Department to reduce the number of employees in loan guaranty, and as a result, both loan servicing and property management suffered. Inevitably, this has produced vastly increased indebtedness for both veterans and the Department of Veterans Affairs.

Consistent with the need for timely and intensive servicing of defaults is the necessity for computerization. Unfortunately, the Department of Veterans Affairs has been extremely slow in setting up any reasonable loan guaranty computer application because funds necessary to support such an application have not been requested by OMB.

Therefore, since 1983, nearly $2.3 billion in external financing has been needed for the LGRF. Out of that total, nearly $1 billion was needed in fiscal year 1988 alone. The additional money was necessary to pay losses incurred by the federal government as a result of foreclosures. The Fund is experiencing a similar trend in fiscal year 1989. It should be noted that $658 million has already been appropriated for fiscal year 1989 and another $120 million supplemental is awaiting Congressional action.

Discussion of the Bill

MORTGAGE INDEMNITY FEE

Over the last several years, the Administration has submitted legislative proposals to the Congress to increase the 1 percent funding fee to make the Loan Guaranty Revolving Fund self-sustaining. The proposals would have increased the funding fee in FY 1986 from 1 to 5 percent; from 1 to 3.8 percent on a graduated scale in FY 1987; and from 1 to 2.5 percent in FY 1988. President Reagan's budget for FY 1990 proposed a 3.8-percent fee and President Bush's revised FY 1990 budget requested the permanent extension of the 1-percent fee.

When the Congress enacted the 1 percent origination fee in 1984, the fee bore a responsible relationship to the administrative costs of servicing loans. The Administration proposals to increase the fee have had no bearing on actual expenses associated with a veteran's loan but rather have been loosely based on a given year's expenditures resulting from loans made in prior years.

Because of the mounting deficit over the past five years, several hearings have been held on the solvency of the program. The hearings focused on potential solutions which would keep the entitlement nature of the program intact while creating a more prudent funding mechanism.

The Committee believes that the reported bill offers an approach that will put the Home Loan Guaranty Program on a sound financial footing and achieves the objective of maintaining the beneficial entitlement nature of the program. According to the Congressional Budget Office, the proposed new mortgage indemnity program would be more fiscally sound than the current loan guaranty program because of its fee structure and government contribution. It would replace the 1 percent user's fee paid by veterans who obtain guaranteed home loans with a 1¼ percent mortgage indemnity fee. The government would contribute ¼ of 1 percent of the value of the loan over a three year period—an overall ¾ percent contribution. Service-connected disabled veterans rated 10 percent or more and surviving spouses of veterans whose deaths are service connected would be exempt from paying this fee. Veterans who make a downpayment of 5 percent or more would be charged a ¾-percent fee.

In exchange for the payment of a higher fee, veterans would be released from liability to the Department of Veterans Affairs in the event of foreclosure unless there are indications of fraud, misrepresentation or bad faith on the part of the veteran in connection with either the loan origination or the foreclosure. The veteran would continue to be liable for the debt to the lender. This change in policy is consistent with the practices of commercial lenders and other federal housing programs.

The bill's fee structure was based upon the Federal Housing Administration's (FHA) experience in formulating its mortgage insurance fee. FHA computer models were used to calculate a one-time fee based on the Department of Veterans Affairs' past and projected foreclosure statistics. Projections were formulated to calculate the present value of expected income equal to the sum of projected expenses associated with these new loans.

The new "fee" structure, according to the FHA model, should be approximately two percent for the new indemnity program based on the following assumptions:

(1) The term of the loan is 30 years;

(2) The contract interest rate is 10 percent compounded monthly;

(3) The discount rate is 6.5 percent compounded semi-annually;

(4) The loss ratio is 30 percent of the original mortgage amount;

(5) The ultimate claim rate is 8.03 percent and claims occur as in Table 1. Moreover, the claim rates in Table 1 are calculated by taking a weighted average of the Department's actual experience through the end of fiscal year 1987 as shown in Table 2. Each loan received equal weight in the averaging process.

TABLE 1—CLAIM RATES BY POLICY YEAR

Policy Year:	*(Percent Claim Rate)*
1	.02
2	.56
3	1.45
4	1.44
5	1.15
6	.80
7	.59
8	.45
9	.29
10	.20
11	.14
12	.11
13	.09
14	.08
15	.05
16	.04

NOTE: For policy years 17-30, the claim rate for the 16th policy year was used.

Table 2—Claims Based on Loan Date vs. Termination Date

(Includes Manufactured Home Loans Through September 30, 1987)

Fiscal Year Terminated	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972
1987	677	4,425	7,708	8,384	3,415	4,053	4,385	3,220	1,760	992	577	375	320	193	150
1986	4	904	5,073	7,296	4,083	4,642	4,150	2,989	1,541	873	535	337	305	236	155
1985		14	1,269	5,198	4,704	6,087	4,772	3,280	1,676	941	565	373	338	232	222
1984			17	1,139	4,444	6,988	5,581	3,625	1,712	1,059	607	462	391	295	217
1983				10	1,391	5,850	5,579	3,643	1,802	1,073	678	496	416	303	262
1982					34	1,768	4,815	3,535	1,922	1,095	735	563	437	294	293
1981						36	2,129	3,661	2,215	1,363	885	657	550	411	313
1980							44	1,430	2,743	2,205	1,619	1,139	941	693	517
1979								26	1,279	2,723	3,106	3,146	2,797	1,388	1,027
1978									34	1,297	3,052	2,428	2,142	1,233	847
1977										36	1,615	3,471	3,465	1,967	1,236
1976											59	2,179	4,957	2,980	1,989
1975												102	3,136	4,150	2,958
1974													115	2,474	4,232
1973														82	2,483
1972															93
Partial Claims * (Still active)	1	6	24	45	18	74	112	153	155	101	26	15	1		
Total Liquidated	682	5,349	14,091	22,072	18,089	29,498	31,567	25,562	16,839	13,758	14,059	15,743	20,311	16,931	16,994

* Partial claims contain no termination date.
Note: FY 1979 terminations include some loans terminated in previous years.

The Committee bill would continue the current 1-percent fee for vendee loans and the ½-percent fee for assumed loans. Purchasers would remain liable to the Federal Government in the event of default.

The Committee bill would establish a new account to receive these collections as well as to pay obligations incurred in connection with loans closed after the date of enactment, and would give the Department of Veterans Affairs the authority to invest excess monies in government securities. FHA currently has authority to invest its excess funds. According to the Congressional Budget Office, if fund balances are invested in 90-day Treasury bills, interest collections would be approximately $195 million over the next five years.

Even though the Committee bill would replace the Home Loan Guaranty Program with a mortgage indemnity program, the effect on the program's operations would be relatively minor. The Committee bill is essentially a financing measure, designed to ensure that sufficient capital is placed in the revolving fund at the time new loans are guaranteed or insured to cover the anticipated cost of defaults to those loans. The Congressional Budget Office estimates that the mortgage indemnity fund should carry a significant unobligated balance through the 1990's.

In addition, since the Department of Veterans Affairs collects only 7 percent of outstanding debts today, the Congressional Budget Office estimates that the provision in the bill which would eliminate debts on loans made after the effective date would have no impact on the fund.

The Committee bill would not affect the current features of no-downpayment loans up to $144,000, and the Department of Veterans Affairs will continue to set interest rates, which historically have been somewhat less than conventional rates. In addition, the nature of the guaranty to the lending community is not being changed.

The Committee hopes that this long-range plan toward solvency will deter any efforts to undermine this program in the future, including "back door" approaches to terminating this program. Unfortunately, many of the Department's administrative decisions over the last several years have been made on the basis of the impact on outlays from the Loan Guaranty Revolving Fund in one fiscal year, rather than a concern for long-term prudent management. The Committee believes that by virtue of this restructuring, the Department will be in a position to cope much more effectively with the program's basic operation. It is believed that a resulting factor will be a much clearer picture of actual program costs.

LOAN PORTFOLIO SALES

Because of the high foreclosure rate over the past several years, and in conformance with Administration efforts to reduce short-term outlays, the Department of Veterans Affairs has been pressured by the Office of Management and Budget to accelerate its loan portfolio sales. Prior to 1988, the Department of Veterans Affairs routinely offered loans for sale with recourse agreements, under which the Department guaranteed to repurchase (or ex-

change for a loan of comparable value) any loan that was delinquent for three months or more. Prior to fiscal year 1988, proceeds of vendee loan sales were scored as offsetting collections of the Loan Guaranty Revolving Fund. Beginning in 1988, however, the proceeds of recourse sales have been redefined as a means of financing rather than a collection and, as such, do not offset outlays.

This new policy was implemented despite criticism from the General Accounting Office (GAO) which issued two reports on the subject of loan asset sales ("Loan Asset Sales, OMB Policies Will Result in Program Objectives Not Being Fully Achieved", September, 1986 and "Loan Asset Sales, An Assessment of Selected Sales", February, 1988). These reports and subsequent testimony before both the Veterans' Affairs and Government Operations Committees pointed out that OMB's guidelines on non-recourse sales would have an adverse effect on the federal government's ability to both market loans and maximize net sales proceeds.

The General Accounting Office's February, 1988, study stated that loan asset sales over the long term will also increase the structural federal budget deficit. GAO further stated that loan asset sales do not effectively measure subsidy costs and that the Administration's plan to define the subsidy cost of federal credit programs as the monetary benefit—interest cost savings—to a borrower would overstate both government cash costs and the related cost to operate credit programs. Public Law 100-136 prohibited the Veterans' Administration from selling vendee loans unless such assets could be sold for par. However, the effect of this provision was suspended until fiscal year 1990, as part of the Omnibus Budget Reconciliation Act of 1987, Public Law 100-203.

Since the enactment of this law, the Department has managed four loan asset sales without offering repurchase agreements. Three of these sales have been accomplished with a two-tier approach. This technique requires that the agency's assets be sold to an investor in exchange for senior and subordinated certificates. The senior certificates, which achieve a high investment grade rating because they have first call on the cash flows from the pool of loans, are widely marketable. The subordinated pool of loans is set aside to cover any losses due to delinquencies or foreclosures attributable to loans securing the senior certificates. In the first sale, closed on June 29, 1988, of the $309 million principal balance of the loans sold, the government realized $179 million at the time of the sale, or 58 percent of the face value of the loans sold. In the second sale, held on September 23, the Department realized 55 percent of the face value of the loans sold or $125 million in cash at the time of sale.

Public Law 100-203 required the Department of Veterans Affairs to provide the Committee with an estimate of the amount the government would have realized on loan asset sales had the loans been sold with repurchase agreements. An analysis of the first two loan sales was performed by the Department's financial advisor, Kidder, Peabody & Co. According to Kidder, Peabody, and Co., the Department would have realized 92 and 91 percent respectively of the face value of the loans at the time of sale if they had been sold with repurchase agreements. Thus, the OMB policy resulted in a loss of cash proceeds to the United States Treasury of over $180 million

on the first two sales. As a result of this policy and the need for higher appropriations to meet program requirements, the deficit was increased by almost this same amount. The Department of Veterans Affairs' loan sale on February 23, 1989 resulted in its receiving 59 percent of the value of the loans sold or $165.5 million in cash at the time of sale. It should be noted that in addition to the substantial subordination, the Department also was required to secure certificate insurance to obtain higher ratings from rating agencies. Coupled with other related sales costs, (i.e., financial advisor, legal representation, underwriting fees, etc.) up front proceeds were further diminished by approximately $20 million for three of the four sales. The fourth sale on March 23, 1989 encompassed older loans with an average interest rate of 5.87 percent. Since these loans were considered good risks, the two-tier approach was not adopted. The Department received approximately 85 percent of the face value after deducting $4.5 million in expenses.

At a time when the Home Loan Guaranty Program is experiencing severe financial difficulty (the Congress has had to appropriate nearly $1 billion in fiscal year 1988, and it is anticipated that almost $800 million will be needed in fiscal year 1989), this type of sale makes little sense, especially since the Department of Veterans Affairs has retained all of the inherent risk, as in previous recourse loan sales, while receiving considerably less in up-front money. Nevertheless, the OMB policy was recently agreed to by the House and Senate with the adoption of the FY 1990 Budget Resolution.

The provisions affecting the Department of Veterans Affairs loan asset sales contained in the Omnibus Reconciliation Act of 1987, are scheduled to change on October 1, 1989. The Department will be authorized to sell loans without recourse only if the amount received is not less than the unpaid balance of the loan. However, because of the current scorekeeping methods, a continuation of nonrecourse loan sales would "save" $496 million even though it is acknowledged that the Department would receive substantially more money at the time of sale with recourse loan sales.

The Committee believes that if loan asset sales are to continue, they should be conducted in such a way as to maximize cash proceeds to the program. Therefore, the Committee bill would require that regardless of sales methods—with or without recourse—proceeds should be accounted for as offsetting collections of the Fund. The Committee bill also specifies that loans cannot be sold unless 90 percent or better of the unpaid balance is received at the time of sale.

Should this particular provision be enacted into law, the Congressional Budget Office (CBO) estimates that the Department of Veterans Affairs would receive $794 million in loan asset proceeds. By adopting what is essentially a change in scorekeeping rules, this provision results in "savings" that are approximately $300 million higher than the reconciliation instruction to the Committee required by the FY 1990 Budget Resolution. It is the Committee's intent in recommending this provision to reverse a policy which was adopted without consultation by budget "scorekeepers" at OMB and CBO. This reversal of the policy treating loan sales with recourse as a form of financing and refusing to recognize the re-

ceipts as offsetting collections would be effective on the date of enactment. It would require OMB and CBO to treat such receipts as offsetting collections for all budgetary purposes, including reports required to be made under the Gramm-Rudman-Hollings Deficit Reduction provisions, Public Law 99–177, as amended by the Balanced Budget and Emergency Deficit Control Act of 1987, Public Law 100–119.

MODIFICATION OF REFINANCING LOAN PROVISIONS

Under current law and implementing regulations, certain veterans may have their loan guaranty entitlement restored. A veteran may qualify for restored entitlement if he or she has been relieved of liability on a GI loan, which normally is accomplished when the loan is paid in full and the property has been disposed of; or if a veteran-buyer agrees to substitute his or her entitlement for that of the original veteran-borrower and meets all other requirements for substitution of entitlement.

However, it has come to the Committee's attention that once a veteran has refinanced a GI loan conventionally, he or she may no longer refinance that same home through a Department of Veterans Affairs guaranty, even though it remains his primary residence. On the other hand, if the veteran had purchased the home initially with conventional financing, such veteran would be eligible for a Department-backed home loan guarantee. This seems inconsistent with the beneficial intent of the law, and H.R. 1415 would remedy this inequity.

WAIVER

The Home Loan Guaranty Program is designed to afford veterans whose credit and resources might otherwise be inadequate the opportunity to purchase a house without downpayment by using the Government's credit to supplement their own. Implicit in such a benefit is the risk that there will be failures and defaults. Where the veteran has done his or her very best to keep the loan current, the loss of the home can be the most traumatic financial loss in the veteran's life. The waiver statute was designed to afford deserving veterans relief from the double penalty of home loss and substantial debt.

It has always been the Congress' intent to afford waiver relief when equitable considerations warrant it. Recently, however, many cases have been brought to the Committee's attention documenting the Department's reluctance to grant a waiver request if there is even a remote possibility of collecting some part of the indebtedness.

Although the law permits waiver whenever collection of the indebtedness would violate equity and good conscience, the Department relies heavily on two additional criteria—balancing of fault and the veteran's ability to repay. The Committee disagrees with the Department's undue emphasis on these two criteria. By disagreeing, the Committee does not imply that it condones fraud, waste or gross neglect on the veteran's part. The Committee believes that if the veteran is not at fault in creating an indebtedness

due to improper action or lack of action by the Department, relief should be granted to the veteran in such cases.

Similarly, the Committee agrees that ability to repay is a factor which should be examined by the Department, but that consideration should be limited to the veteran's current prospect of repayment and not be based on remote possibilities.

COMPUTATION OF COSTS

When a guaranteed loan goes into default and servicing efforts by the holder and the Department of Veterans Affairs fail, the holder proceeds with termination of the loan. The rights and duties of the holder and the Department in connection with termination of the loan and disposition of the property are governed by 38 CFR 36.4320. In most cases, the Department establishes a maximum price which the holder may bid at the loan foreclosure sale. Establishment of such a price, known as the "specified amount", occurs when it is determined that the net value of the real property to the Department exceeds the unguaranteed portion of the indebtedness, so that the Department can reduce its maximum claim liability by acquiring and reselling the property. If the property is sold to the holder at the foreclosure sale for a price no higher than the amount specified by the Department, the holder may convey the property to the Department in return for payment of the specified amount. The Department also pays the holder's claim for the difference between the price paid for the property (which must be credited to the loan indebtedness by the holder), and any balance remaining on the loan, but not to exceed the maximum amount of loan guaranty. In this manner, the Department may acquire the loan security (the home) and reduce its claim liability.

The formula (commonly known as the no-bid formula) for determining whether the Department of Veterans Affairs will offer the lender an election to convey the foreclosed property to the Department is set forth at 38 CFR 36.4320 which is based on the provisions of 38 U.S.C., § 1832. A key component of this formula is the "net value" of the property. Essentially, "net value" is the fair market value of the property minus the total costs the Secretary estimates would be incurred by the Department resulting from the acquisition and disposition of the property for property taxes, assessments, liens, property maintenance, property improvement, administration and resale.

On March 31, 1989, the Department of Veterans Affairs published a proposed regulation that would, effective October 1, 1989, take into account the government's cost of borrowing when calculating the "net value" of a property. On April 5, the Department proposed to make the effective date August 1, 1989.

By taking this action to implement the "net value" definition for FY 1989, the Department has ignored the procedure set forth by Congress in the language of the Conference Report accompanying P.L. 98-369, the "Deficit Reduction Act of 1984", which contained the no-bid formula. In that report, the conferees stated:

"In connection with the VA's calculation of costs of acquiring and disposing of properties, the conferees do not intend to change the VA's current policy of not considering interest costs that the

United States would incur if it were necessary for the government to borrow the funds for a particular acquisition. If the Administrator determines that change of this policy is warranted, notwithstanding the conferees' position as stated above, the Administrator shall, not later than February 1 preceding the fiscal year in which a proposed change would take effect, provide the Veterans' Affairs Committees with notice of the change." The Department's proposed regulation disregards the procedure and intent set forth by the Congress. Because the Secretary is not charged any interest costs for funds used in acquiring a foreclosed property, the cost of government borrowing is not a cost incurred by the Secretary and should not be permitted under the statute to be included in the definition of "net value".

The Committee bill would extend the no-bid formula for two years, from October 1, 1989 to October 1, 1991, and would prohibit the Secretary from considering any estimated imputed interest cost of funds to the Government in establishing "net value".

NOTIFICATION REQUIREMENT

Section 36.4315 of title 38 of the Code of Federal Regulations requires that lenders notify the Department of Veterans Affairs within 90 to 105 days of pending home loan defaults. Following the receipt of such a notice, the Department of Veterans Affairs is required by law to service the loan by providing the veteran with information and, to the extent feasible, counseling regarding alternatives to foreclosure, as appropriate in light of the veteran's particular circumstances, including possible methods of curing the default. However, overall Loan Guaranty employment has decreased by 370 people, from 2,470 to 2,100, during the 10-year period from 1978 to 1988. During the same period of time, the number of claims filed rose from 14,399 to 50,285 and properties on hand have also increased 11,291 to 21,161. This reduction in personnel and increase in workload has resulted in servicing efforts which are usually inadequate or nonexistent.

High foreclosure levels continue to be a major challenge. The General Accounting Office has repeatedly testified before the Committee that intensive and timely servicing of defaults reduces ultimate foreclosures and subsequent claims and property management expenses. On May 11, 1989, at a hearing before the Subcommittee on Housing and Memorial Affairs, the Loan Guaranty Officer from Denver indicated that the default caseload was 1,800 per employee. Such a ratio would make it impossible to ascertain which loans had the potential to be cured.

It recently came to the Committee's attention that although the Department's regulations require mortgage lenders to accept partial payments, if certain conditions are met, from veterans facing temporary financial difficulties, returns of such payments by mortgage companies occur on a regular basis. By the time the lender notifies the Department of the delinquency, the veteran is already 3 or 4 months in arrears and may be in a position of never being able to bring the loan current. The Committee bill would therefore require early notification to the Department by lenders in those instances where partial payments have been tendered by the veteran

but refused by the holder. Such notification must include a statement of the circumstances of the default and the reasons for the holder's refusal.

The Committee believes that this early notification to the Department will target these particular cases as potentially curable since the veteran has demonstrated a desire to avoid foreclosure. The Committee anticipates that special consideration will be given to these veterans by Loan Guaranty employees in their servicing efforts and that this will result in fewer foreclosures. The government will save money and veterans will not lose their homes.

Section-by-Section Analysis of the Reported Bill

Section 1.—The Short Title states that this bill may be cited as the "Veterans' Home Loan Mortgage Indemnity Act of 1989."

Section 2.—Establishment of Special Indemnity Fund and Loan Fee.

Subsection (a) would add a new section 1824A to title 38, United States Code:

Subsection (a) of the new section 1824A would establish a new revolving fund known as the Veterans' Mortgage Indemnity Fund (MIF).

Subsection (b) of the new section 1824A provides that the MIF would pay for all housing loan operations, other than administrative expenses, with respect to loans originally guaranteed or insured by the Secretary of Veterans Affairs on or after October 1, 1989 (hereafter "new loans").

Subsection (c) of the new section 1824A provides that revenues from the loan fee on new loans would be deposited into the MIF. In addition, there would be credited to the MIF an amount equal to ¼ of 1 percent of the original loan amount of each new loan. This credit would be made each year for 3 fiscal years beginning in the year a loan was guaranteed. All amounts collected by DVA with respect to new loans; e.g., the proceeds from the sale of the property, following foreclosure, would also be deposited in the MIF. In addition, interest earned pursuant to subsection (d) of this new section would be deposited into the MIF.

Subsection (d) of the new section 1824A would require the Secretary of the Treasury to invest the balance of the MIF not required to meet current expenses in interest bearing obligations of the United States or guaranteed by the United States.

Subsection 2(b) would make the following amendments to 38 U.S.C. § 1829 relating to the loan fee: The fee for new guaranteed loans would be increased from the present 1 percent to 1.25 percent of the loan amount. If, however, the veteran obtains a loan to purchase or construct a dwelling and makes a 5 percent down payment, the fee would be decreased to ¾ of 1 percent. The September 30, 1989, sunset for the fee would be repealed. (The exemption from paying the fee currently granted to disabled veterans and surviving spouses and the fees currently charged vendee loan borrowers and persons assuming existing loans pursuant to 38. U.S.C. § 1814 would remain unchanged.)

Subsection (c) would provide that veterans who pay the fee on new guaranteed loans, or who are exempt from paying such fee, on

or after October 1, 1989, would have no liability to DVA following foreclosure, except in the case of fraud, misrepresentation, or bad faith in obtaining the loan or in connection with the loan default.

Subsection (d) would make conforming amendments to 38 U.S.C. § 1824 (relating to the existing Loan Guaranty Revolving Fund) and certain other provisions.

Subsection (e) would make the amendments made by this section applicable to loans closed on or after October 1, 1989.

Section 3.—Sale of Vendee Loans. Subsection (a) would allow DVA to sell vendee loans either with or without recourse, but only if the amount received at the time of sale is equal to at least 90 percent of the unpaid balance on the loans. This section further provides that, for budget purposes, amounts received from the sale of such loan shall be considered offsetting collections of the Loan Guaranty Revolving Fund, without any reduction, regardless of whether the loans are sold with or without recourse.

Subsection (b) would make this section effective October 1, 1989.

Section 4.—Computation of Entitlement Amount. This section would permit DVA to restore a veteran's previously used loan guaranty entitlement if the prior loan has been paid in full. Under current law, the veteran must also dispose of the property which secured the prior loan.

Section 5.—Waiver. This section would amend 38 U.S.C. § 3102(c) which pertains to waiver of veterans' debts to DVA. The amendment would delete misrepresentation, material fault, and lack of good faith as bars to waiver of all such debts. Therefore, only fraud would preclude consideration of waiver. In addition, this section would provide that in considering whether under the statutory standard of "equity and good conscience" a veteran's housing loan debt should be waived, DVA will not consider solely a balancing of fault or whether the veteran might be able to repay the indebtedness.

Section 6.—Computation of Costs; Extension. Subsection (a) would amend the definition of "net value" contained in 38 U.S.C. § 1832(c)(1)(C) by providing that DVA may not consider imputed interest costs as one of the costs of acquiring and disposing of a property.

Subsection (b) would extend the sunset for 38 U.S.C. § 1832(c) from October 1, 1989 to October 1, 1991. That subsection contains the criteria for determining DVA's guaranty liability and whether DVA may accept title to the security property following foreclosure.

Section 7.—Notification Requirement. This section would require the holder of a guaranteed loan to notify DVA if such holder refused to accept a partial payment from a veteran whose loan was in default. The holder would be required to advise DVA of the circumstances of the default and the reasons the holder refused to accept a partial payment.

Oversight Findings

No oversight findings have been submitted to the Committee by the Committee on Government Operations.

BUDGET STATEMENT

The following letter was received from the Congressional Budget Office concerning the cost of the reported bill.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C., May 17, 1989.

Hon. G.V. (Sonny) Montgomery, *Chairman,*
Committee on Veterans' Affairs,
U.S. House of Representatives,
Washington, D.C. 20515

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the attached cost estimate for H.R. 1415, the Veterans' Home Loan Mortgage Indemnity Act of 1989, as ordered reported by the Committee on Veterans' Affairs, May 17, 1989.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

ROBERT D. REISCHAUER,
Director.

cc: Hon. Bob Stump
Ranking Minority Member

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: H.R. 1415.
2. Bill title: Veterans' Home Loan Mortgage Indemnity Act of 1989.
3. Bill status: As ordered reported by the House Committee on Veterans' Affairs, May 17, 1989.
4. Bill purpose: To improve the operation of the veterans' home loan guaranty program.
5. Estimated cost to the Federal Government:

[By fiscal years, in millions of dollars]

	1990	1991	1992	1993	1994
Budget Authority	35	80	61	−88	−212
Outlays	−197	−206	−213	−219	−220

Basis of Estimate—The following section-by-section cost analysis only addresses those sections of the bill that could be expected to have a significant budgetary impact.

SECTION 2. This section would replace the existing home loan guaranty program with a new home loan insurance program for veterans. A new revolving fund, the Mortgage Indemnity Fund (MIF), would be established to manage the financial activities of the new program. Under the new program, the origination fee paid by most VA borrowers would be 1.25 percent of the mortgage principal. (The current fee of 1.0 percent will expire at the end of fiscal year 1989.) In the case of individuals who make downpayments of 5 percent or more, the fee would be 0.75 percent, and vendee loan recipients would pay 1.0 percent.

Under the new program, the Government would also contribute its share of the anticipated future default costs of the loans at the time of origination. Government contributions of 0.75 percent of the mortgage principal would be made to the loan fund for each loan insured. The Government contribution for a loan, however, would be spread over three years, with 0.25 percent paid in each of the first three years after origination. The VA would also be authorized to invest any excess balances of the revolving fund in U.S. Treasury securities.

Finally, veterans obtaining mortgages under the new program would not be held liable for any debt related to the mortgage that is not satisfied by the sale of the securing property after foreclosure.

[By fiscal years, in millions of dollars]

	1990	1991	1992	1993	1994
Loan Guaranty Revolving Fund:					
Budget Authority	−8	−27	−134	−358	−560
Outlays	−7	−26	−133	−357	−559
Mortgage Indemnity Fund:					
Budget Authority	42	89	154	207	275
Outlays	−191	−198	−121	75	266
Function 900 Offset:					
Budget Authority	1	18	41	63	73
Outlays	1	18	41	63	73
Net Budget Impact:					
Budget Authority	35	80	61	−88	−212
Outlays	−197	−206	−213	−219	−220

This estimate was prepared from a model that interrelates the various obligation and collection activities of the veterans' home loan guaranty program. This model is based on historical relationships and projects these relationships using past trends and expectations of future economic activity.

Even though H.R. 1415 would abolish the current VA home loan program and would replace it with a mortgage indemnity program, and effects on the program's operations would be relatively minor. The bill is essentially a financing measure, designed to ensure that sufficient capital is placed in the revolving fund at the time new loans are insured to cover the anticipated cost of defaults of those loans.

The outlays of the Loan Guaranty Revolving Fund (LGRF) would be expected to fall substantially under this bill, because the default costs of loans insured after the October 1, 1989 effective date would be paid from the Mortgage Indemnity Fund. The MIF would experience negative outlays in 1990–1992, while the default costs of new loans are less than the amount of fees collected on those loans and the interest earned on the investment of the fund's balance. After 1992, MIF default costs are expected to exceed offsetting collections and to result in positive outlays.

This does not mean that the MIF would operate at a deficit during this period, however. The MIF should continue to carry a significant unobligated balance through the 1990's as a result of Federal contributions and proceeds from loan sales. These two

forms of financing would increase the balances of the fund that are available for obligation but would not offset outlays.

Virtually all the net outlay savings attributable to section 2 result from the extension of the VA's authority to charge origination fees and from the increase of 0.25 percent in the fee charged to most borrowers. The authority for the 1.0 percent origination fee would expire at the end of fiscal year 1989 under current law.

According to VA data, approximately 72 percent of the individuals obtaining VA-guaranteed loans make downpayments of less than 5 percent. Under this bill these borrowers would pay an origination fee of 1.25 percent, while the 28 percent of borrowers who make larger downpayments would pay a fee of only 0.75 percent. It is not expected that either of these fee changes is large enough to significantly affect the number of individuals obtaining VA loans or the size of their downpayments.

The elimination of the continuing liability of defaulting borrowers for any debt remaining after the sale of the securing property should have a small impact on the revolving fund, because the VA collects only about 7 percent of such debt now. It is not expected that this release from liability would significantly influence the default rate.

Additional Function 700 outlay savings are generated by the authority of the MIF, to invest the unobligated balances of the fund in Treasury securities. It was assumed that fund balances would be invested in 90-day Treasury bills. Interest collections of the fund are estimated at around $195 million between 1990 and 1994. While these collections would reduce the outlays of the MIF there would be a corresponding increase in outlays from the Treasury. Thus, there would be no net effect of this provision on total Federal spending.

SECTION 3. Under current law the VA is required to recommence selling vendee loans with recourse as of October 1, 1989. This section would specify that the proceeds of such sales should be credited as offsetting collections of the revolving fund, rather than—as under the current accounting rules—as a form of financing. It is CBO policy that provisions that would change existing accounting practices are not scored until after enactment. If CBO were to score bills under the proposed practice rather than under existing scorekeeping rules, we would be changing the rules at the suggestion of one Member or committee rather than at the direction of the entire Congress.

Should this section be enacted, however, the effects on the two housing revolving funds would be as shown in the table below. These estimates are provided for informational purposes only and are not included in the bill totals on page 1.

[By fiscal years, in millions of dollars]

	1990	1991	1992	1993	1994
Loan Guaranty Revolving Fund:					
Budget Authority	−794	−753	−700	−618	−522
Outlays	−794	−753	−700	−618	−522
Mortgage Indemnity Fund:					
Budget Authority	0	−3	−22	−69	−130

	1990	1991	1992	1993	1994
Outlays	0	−3	−22	−69	−130
Total:					
Budget Authority	−794	−756	−722	−687	−652
Outlays	−794	−756	−722	−687	−652

SECTION 6. The VA has published proposed regulations that would include the Government's cost of borrowing in the calculation used to determine whether the VA should acquire a property at foreclosure in order to satisfy their guaranty on a defaulted loan or whether they should pay the guaranty and leave the property with the lender. This provision would prohibit the proposed regulations.

Because these regulations were not anticipated at the time the CBO baseline was developed, it is not reflected in the baseline projection. Thus, there would be no effect on the baseline of disallowing the regulations. The estimated savings that would result from the regulatory change are shown below for informational purposes:

[By fiscal years, in millions of dollars]

	1989	1990	1991	1992	1993	1994
Budget Authority	−25	−117	−89	−80	−73	−68
Outlays	−25	−117	−89	−80	−73	−68

6. Estimated cost to State and local governments: The Congressional Budget Office has determined that the budgets of State and local governments would not be significantly affected by enactment of this bill.

7. Estimate comparison: None.

8. Previous CBO estimate: None.

9. Estimate prepared by: K.W. Shepherd (226-2820).

10. Estimate approved by:

C.G. NUCKOLS,
(FOR) JAMES L. BLUM,
Assistant Director for Budget Analysis.

DEPARTMENT REPORT

The Committee received the following letter from the Department of Veterans Affairs on H.R. 1415.

DEPARTMENT OF VETERANS AFFAIRS,
OFFICE OF THE SECRETARY OF VETERANS' AFFAIRS,
Washington, D.C., May 16, 1989.

Hon. G.V. Montgomery, *Chairman,*
Committee on Veterans Affairs,
U.S. House of Representatives,
Washington, D.C. 20515

DEAR MR. CHAIRMAN: On May 17, 1989, the full Committee on Veterans' Affairs is scheduled to mark up H.R. 1415, the "Veterans' Home Loan Mortgage Indemnity Act of 1989" as reported by

the Subcommittee on Housing and Memorial Affairs. The Department of Veterans Affairs wishes to make the following comments on this measure.

As the Department testified before the subcommittee on April 18, 1989, we share the concern of your committee about the future solvency of the Loan Guaranty Program. We note that the subcommittee modified some of the provisions of the bill to meet some of the concerns expressed by VA and to correct technical problems identified by us.

Nevertheless, after a thorough review of the substitute approved by the subcommittee, we still cannot support H.R. 1415.

As our testimony more fully explained, there are certain provisions in the original bill that would not improve the operation or solvency of the home loan program. These include the release of liability for veterans obtaining loans on or after October 1, 1989, the requirement for 90 percent of par cash proceeds on the day of sale for selling loans without recourse, the use of permanent budget authority to pay a Government contribution and the assumption that it would be sufficient to preserve the liquidity of the new Mortgage Indemnity Fund, and the ability of the existing Revolving Fund to pay the costs associated with loans already guaranteed.

The subcommittee modified the release of liability provisions of section 2(c) of the bill. As reported, veterans obtaining loans after September 30, 1989, would have no liability to VA following the foreclosure of a guaranteed housing loan except in the case of fraud, misrepresentation, or bad faith in obtaining the loan, or in connection with the default. We agree that no special consideration is due in the case of fraud, misrepresentation, or bad faith, and we commend the subcommittee for carving out those exceptions. The VA, however, continues to oppose the concept of a general release of liability following foreclosure. VA currently has authority to waive debts in appropriate cases. We, therefore, still cannot support this provision.

With regard to the sale of vendee loans, the subcommittee added a new provision, section 3(a), relating to the scoring of loans sold without recourse. The bill would require all loans sold, whether with or without recourse, to be credited as offsetting collections of the loan funds without reduction. VA opposes this provision. When loans are sold with recourse, the Government guarantees repayment of principal and interest in the event of default. Accordingly, established budget scorekeeping conventions recognize that the proceeds from such sales are a means of financing outlays, like borrowing, not an offset to outlays. Treating sales with recourse as a collection misstates the true cost of the transaction to the Government. Therefore, the proposed amendment is contrary to sound fiscal management, and violates the basic premise of the Administration's loan asset sales program.

The subcommittee added a new section 6 to H.R. 1415. Subsection (a) of that section would prohibit VA from considering imputed interest costs as one of the costs associated with acquisition and disposition of a property in computing the "net value" of the property pursuant to 38 U.S.C. § 1832(c).

VA opposes this provision.

The provisions of section 1832(c) title 38, United States Code, which were originally added by section 2512(a)(2) of the Deficit Reduction Act of 1984 (DRA), Public Law 98-369, determine the VA's claim liability under a home loan guaranty and when the VA may acquire the property which secured the loan.

Section 1832(c) of title 38 requires the VA to establish a net value for the security property. "Net value" is the fair market value minus costs the VA would incur, if it acquired the property, to acquire, manage, and dispose of such property. Generally, the VA may acquire the property if the net value exceeds the unguaranteed portion of the loan, and the loan holder acquires the property for the lesser of net value or the veteran's total indebtedness. In such cases, net value also represents a minimum amount the loan holder must credit to the veteran's indebtedness in determining the VA's guaranty liability. This provision has provided a useful framework to determine when it is cost-effective either to acquire a VA guaranteed property at foreclosure or to pay the full guaranty amount.

Section 1832(c) specifically requires VA, in computing "net value" to consider "other costs resulting from the acquisition and disposition of the property." The Federal Government is presently required to borrow money in the capital markets in order to cover all its operating expenses. The cost of borrowing these funds is a part of the true cost of running the Government. In the VA Loan Guaranty Program, VA's outlays to acquire a foreclosed property are not recouped until such time as the property is sold. By including the imputed interest cost of holding properties in inventory, the revised definition of "net value" will more realistically reflect the true cost to the Government of a decision to provide the holder of a loan the option of conveying the property to the VA. This, in turn, will assure that VA does not acquire foreclosed properties except when it is in the best interest of the Government to do so.

Furthermore, section 6(a) would eliminate significant savings due to fewer property acquisitions. These savings are assumed in the fiscal year 1989 supplemental request for this program and in the fiscal year 1990 funding level currently being negotiated.

Section 6(b) of H.R. 1415 would extend the sunset of section 1832(c) of title 38 from October 1, 1989, to October 1, 1991. The DRA amendments were enacted to reduce the Government's losses on foreclosure of VA guaranteed loans and the subsequent resale of VA acquired properties and insure that the VA Home Loan Program would continue to provide a viable benefit for veterans and lenders. Experience has shown that these procedures have worked well. The basic framework created by DRA, as amended, and now codified at section 1832(c), is sound and should be continued. Rather than a 2-year extension as proposed by H.R. 1415, however, VA recommends that these provisions be made permanent.

The subcommittee also added a new section 7 to H.R. 1415. This new section requires loan holders to notify VA if they refuse to accept a partial payment tendered by a veteran whose guaranteed loan is in default. A VA regulation (38 C.F.R. § 36.4315(b)) currently requires loan holders to accept partial payments under certain circumstances. VA stresses this regulation in its loan servicing ef-

forts, and periodically reminds program participants of the requirements of this provision.

We do not, however, favor section 7 of the bill. Notification by holders to VA that a partial payment has been returned implies that VA will intervene in curing the delinquency at an early stage. VA may better direct its limited resources to the more seriously delinquent loans. According to the February 28, 1989, National Delinquency Survey of the Mortgage Bankers Association, approximately 4 percent and 1 percent of VA loans are, respectively, 30 and 60 days delinquent, while approximately 1.1 percent are 90 days past due. Workloads may increase by comparable percentages as a result of this amendment, and we do not believe this provision will significantly assist veterans.

The Office of Management and Budget advises that there is no objection from the standpoint of the Administration's program to the submission of this report on H.R. 1415 to the Congress.

Sincerely yours,

EDWARD J. DERWINSKI,
Secretary.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

TITLE 38, UNITED STATES CODE

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PART III—READJUSTMENT AND RELATED BENEFITS

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CHAPTER 37—HOUSING AND SMALL BUSINESS LOANS

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SUBCHAPTER III—ADMINISTRATIVE PROVISIONS

1820. Powers of Administrator.
1821. Incontestability.
1822. [REPEALED.]
1823. Direct loan revolving fund.
1824. Loan guaranty revolving fund.
1824A. Mortgage indemnity fund.

* * * * * * *

SUBCHAPTER I—GENERAL

§ 1802. Basic entitlement

(a) * * *

(b) In computing the aggregate amount of guaranty or insurance housing loan entitlement available to a veteran under this chapter, the Administrator may exclude the amount of guaranty or insurance housing loan entitlement used for any guaranteed, insured, or direct loan, if—

(1)(A) the property which secured the loan has been disposed of by the veteran or has been destroyed by fire or other natural hazard; and

(B) the loan has been repaid in full, or the Administrator has been released from liability as to the loan, or if the Administrator has suffered a loss on such loan, the loss has been paid in full; [or] *; or*

(2) a veteran-transferee has agreed to assume the outstanding balance on the loan and consented to the use of the veteran-transferee's entitlement, to the extent that the entitlement of the veteran-transferor had been used originally, in place of the veteran-transferor's for the guaranteed, insured, or direct loan, and the veteran-transferee otherwise meets the requirements of this chapter[.]

(3) the loan has been repaid in full.

The Administrator may, in any case involving circumstances the Administrator deems appropriate, waive one or more of the conditions prescribed in clause (1) of the preceding sentence.

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§ 1803. Basic provisions relating to loan guaranty and insurance

(a) * * *

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(e) Any veteran who pays a fee under section 1829 of this title, or is exempted under section 1829(c) from paying such fee, on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989 with respect to a housing loan (other than a loan made under section 1833(a) or a loan for which a fee is collected under section 1829(b)) shall have no liability to the Secretary with respect to the loan for any loss resulting from any default of the veteran except in the case of fraud, misrepresentation, or bad faith by the veteran in obtaining the loan or in connection with the loan default.

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SUBCHAPTER III—ADMINISTRATIVE PROVISIONS

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§ 1824. Loan guaranty revolving fund

(a) There is hereby established in the Treasury of the United States a revolving fund known as the Veterans' Administration Loan Guaranty Revolving Fund (hereinafter called the Fund).

(b) The Fund shall be available to the Administrator when so provided in appropriation Acts and within such limitations as may be included in such Acts, without fiscal year limitation, for all housing loan guaranty and insurance operations under this chapter, except administrative expenses *and the operations carried out with the Indemnity Fund established by section 1824A*. For purposes of this subsection, the term 'administrative expenses' shall not include expenses incurred by the Administrator for appraisals performed after February 1, 1986, on a contractual basis in connection with the liquidation, of housing loans guaranteed, insured, or made under this chapter.

(c) There shall be deposited in the Fund (1) by transfer from current and future appropriations for readjustment benefits such amounts as may be necessary to supplement the Fund in order to meet the requirements of the Fund, (2) amounts received by the Administrator as fees collected under section 1829 of this title *before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989, except that fees collected under subsection (b) of such section 1829 on or after such effective date with respect to loans which were originally guaranteed, made, or insured before such effective date shall also be deposited in the Fund,* and (3) all amounts now held or hereafter received by the Administrator incident to housing loan guaranty and insurance operations under this chapter *with respect to housing loans guaranteed or insured under*

this chapter before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989, including but not limited to all collections of principal and interest and the proceeds from the use of property held or the sale of property disposed of.

* * * * * * *

§ 1824A. Mortgage indemnity fund

(a) There is hereby established in the Treasury of the United States a revolving fund known as the Veterans' Mortgage Indemnity Fund (hereinafter referred to as the "Indemnity Fund").

(b) The Indemnity Fund shall be available to the Secretary for all operations (other than administrative expenses) carried out with respect to housing loans guaranteed or insured under this chapter which are made on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1989, other than loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

(c)(1) All fees collected under section 1829 of this title on or after such effective date shall be credited to the Indemnity Fund, other than fees collected with respect to loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

(2) There shall also be credited to the Indemnity Fund—

(A) for each housing loan guaranteed or insured under this chapter on or after October 1, 1989, an amount equal to 0.25 percent of the original amount of such loan for each of the three fiscal years beginning with the fiscal year in which such loan is guaranteed or insured;

(B) all collections of principal and interest and the proceeds from the use of property held, or from the sale of property disposed of, with respect to loans to which subsection (b) of this section applies; and

(C) all income from the investments described in subsection (d) of this section.

(d)(1) The Secretary of the Treasury shall invest the portion of the Indemnity Fund that is not required to meet current payments made from the Indemnity Fund, as determined by the Secretary of Veterans' Affairs, in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

(2) Such obligations shall have maturities suitable to the needs of the Indemnity Fund, as determined by the Secretary of Veterans' Affairs, and shall bear interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities.

* * * * * * *

§ 1829. Loan fee

[(a) Except as provided in subsection (b) of this section, a fee shall be collected from each veteran obtaining a housing loan guaranteed, made, or insured under this chapter, and from each person obtaining a loan from the Administrator to finance the purchase of

real property from the Administrator, and no such loan may be guaranteed, made, or insured under this chapter until the fee payable with respect to such loan has been remitted to the Administrator. The amount of the fee shall be one percent of the total loan amount. The amount of the fee may be included in the loan and paid from the proceeds thereof.

[(b) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.

[(c) A fee may not be collected under this section with respect to any loan closed after September 30, 1989.

[(d) Except as provided in subsection (b) of this section, a fee shall be collected from a person assuming a loan to which section 1814 of this chapter applies. The amount of the fee shall be equal to one-half of one percent of the balance of such loan on the date of the transfer of the property.]

§ 1829. Loan fee

(a)(1) Except as provided in subsection (c), a fee shall be collected from each veteran obtaining a housing loan guaranteed or insured under this chapter, and from each person obtaining a loan under section 1833(a), and no such loan may be guaranteed, made, or insured under this chapter until the fee payable under this section has been remitted to the Secretary.

(2) The amount of such fee shall be 1.25 percent of the total loan amount, except that—

(A) in the case of a loan made under section 1833(a), the amount of such fee shall be one percent of the total loan amount; and

(B) in the case of a guaranteed or insured loan for a purchase or construction with respect to which the veteran has made a downpayment of not less than 5 percent of the total purchase price or construction cost, the amount of such fee shall be 0.75 percent of the total loan amount.

(3) The amount of the fee may be included in the loan and paid from the proceeds thereof.

(b) Except as provided in subsection (c), a fee shall be collected from a person assuming a loan to which section 1814 of this title applies. The amount of the fee shall be equal to one-half of one percent of the balance of the loan on the date of the transfer of the property.

(c) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.

* * * * * * *

§ 1832. Procedure on default

(a)(1) In the event of default in the payment of any loan guaranteed under this chapter, the holder of the obligation shall notify the Administrator of such default. Upon receipt of such notice, the Administrator may, subject to subsection (c) of this section, pay to such holder the guaranty not in excess of the pro rata portion of the amount originally guaranteed. [If] *Except as provided in section 1803(e), if* the Administrator makes such a payment, the Administrator shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty.

* * * * * * *

(5) In the event of default in the payment of any loan made, guaranteed, or insured under this chapter in which a partial payment has been tendered by the veteran concerned and refused by the holder, the holder of the obligation shall notify the Secretary as soon as such payment has been refused. Such notification shall include a statement of the circumstances of the default and the reasons for the holder's refusal.

* * * * * * *

(c)(1) For purposes of this subsection—

(A) the term "defaulted loan" means a loan that is guaranteed under this chapter, that was made for a purpose described in section 1810(a) of this title, and that is in default.

(B) The term "liquidation sale" means a judicial sale or other disposition of real property to liquidate a defaulted loan that is secured by such property.

(C) The term "net value", with respect to real property, means the amount equal to (i) the fair market value of the property, minus (ii) the total of the amounts which the Administrator estimates the Administrator would incur (if the Administrator were to acquire and dispose of the property) for property taxes, assessments, liens, property maintenance, property improvement, administration, resale, and other costs resulting from the acquisition and disposition of the property *excluding any estimated imputed interest costs of funds to the Government.*

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(11) This subsection shall cease to have effect on October 1, [1989.] *1991.*

§ 1833. Property management

(a)(1) * * *

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[(3)(A) Before October 1, 1989, notes evidencing such loans may be sold with or without recourse as determined by the Administrator, with respect to specific proposed sales of such notes, to be in the best interest of the effective functioning of the loan guaranty program under this chapter, taking into consideration the comparative cost-effectiveness of each type of sale. In comparing the cost-effectiveness of conducting a proposed sale of such notes with recourse or without recourse, the Administrator shall, based on avail-

able estimates regarding likely market conditions and other pertinent factors as of the time of the sale, determine and consider—

[(i) the average amount by which the selling price for such notes sold with recourse would exceed the selling price for such notes if sold without recourse; and

[(ii) the total cost of selling such notes with recourse, including—

[(I) any estimated discount or premium;

[(II) the projected cost, based on Veterans' Administration experience with the sale of notes evidencing vendee loans with recourse and the quality of the loans evidenced by the notes to be sold, of repurchasing defaulted notes;

[(III) the total servicing cost with respect to repurchased notes, including the costs of taxes and insurance, collecting monthly payments, servicing delinquent accounts, and terminating insoluble loans;

[(IV) the costs of managing and disposing of properties acquired as the result of defaults on such notes;

[(V) the loss or gain on resale of such properties; and

[(VI) any other cost determined appropriate by the Administrator.]

(3)(A) The Secretary may sell any note evidencing such a loan with or without recourse, but only if the cash proceeds received at the time of such sale is equal to an amount which is not less than 90 percent of the unpaid balance of such loan.

(B) All amounts received from the sale of such loans shall be credited, without any reduction and for the fiscal year in which the amount is received, as offsetting collections of the Fund, established by section 1824 or by section 1824A, for which a fee was collected (or from which a fee was exempted from being collected) at the time the loan was originally guaranteed. The total credited to such Fund for a fiscal year shall offset outlays attributed to such fund during such fiscal year.

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PART IV—GENERAL ADMINISTRATIVE PROVISIONS

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CHAPTER 53—SPECIAL PROVISIONS RELATING TO BENEFITS

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§ 3102. Waiver of recovery of claims by the United States

(a) * * *

* * * * * * *

(c) The Administrator may not exercise the Administrator's authority under subsection (a) or (b) of this section to waive recovery of any payment or the collection of any indebtedness (or any interest thereon) if, in the Administrator's opinion, there exists in connection with the claim for such waiver an indication of fraud [, misrepresentation, material fault, or lack of good faith] on the part of the person or persons having an interest in obtaining a

waiver of such recovery or the collection of such indebtedness (or any interest thereon). *The Secretary may not make a determination with respect to equity and good conscience under subsection (b) solely on the basis of a balancing of fault or on whether the veteran might be able to repay the indebtedness.*

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